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4 BEFORE THE INSURANCE COMMISSIONER
5 OF THE STATE OF WASHINGTON
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7 In the Matter of

No. G02-45

8 THE APPLICATION REGARDING
9 THE CONVERSION AND
10 ACQUISITION OF CONTROL OF
PREMERA BLUE CROSS AND
ITS AFFILIATES

PRE-FILED RESPONSIVE
TESTIMONY OF PATRICK H.
CANTILO

11 I, Patrick H. Cantilo, do hereby declare that the following facts are personally
12 known to me and, if called upon to do so, I would testify to them.

13 1. Cantilo & Bennett, L.L.P. ("C&B") has reviewed the pre-filed responsive
14 testimony of the witnesses of the PREMERA Group ("PREMERA") and that of the
15 Intervenors. I address herein the effect or significance of certain aspects of this
16 testimony. To the extent that it proposes changes to the Amended Form A and related
17 documents, C&B has not addressed whether, in the aggregate, those changes should be
18 viewed as yet another amendment of the Form A, or a materially different transaction.

19 2. Through the pre-filed direct testimony of Kent S. Marquardt and the pre-
20 filed direct testimony of Gubby Barlow, PREMERA has attempted to address some of
21 the concerns articulated by the consultants (the "Consultants") to the Office of the
22 Insurance Commissioner of the State of Washington (the "OIC") in the "Supplemental
23 Report of Cantilo & Bennett, L.L.P.: An Analysis of the Form A Statement Regarding
24 the Acquisition of Control of a Domestic Health Carrier and a Domestic Insurer

1 Premera Blue Cross, LifeWise Assurance Company, LifeWise Health Plan of
2 Washington, LifeWise Health Plan of Oregon, Inc., Premera Blue Cross Blue Shield of
3 Alaska, and LifeWise Health Plan of Arizona, Inc. direct or indirect affiliates of
4 PREMERA by [New PREMERA Corp.] Filed with the Insurance Commissioner of the
5 State of Washington, the Alaska Division of Insurance, and the Oregon Insurance
6 Division” dated February 27, 2004 (“C&B’s Supplemental Report”), which is presented
7 in Exhibit S-29. Additionally, attached to Mr. Marquardt’s pre-filed direct testimony
8 are exhibits that reflect “corrections such as typographical errors or text which the state
9 consultants felt was ambiguous or did not reflect the intent” of the parties (the
10 “Proposed Modifications”). Paragraphs 3 through 13 of my pre-filed testimony address
11 these Proposed Modifications and other modifications that PREMERA has proposed.

12 3. The Consultants identified a concern regarding the lack of separate
13 representation on the Board of Directors of New PREMERA, Inc. (“New PREMERA”)
14 for each of the foundations (the “Washington Foundation” and the “Alaska
15 Foundation,” referred to collectively as the “Foundations”) to which the shares of New
16 PREMERA’s stock (the “Shares”) are to be transferred. The exhibits attached to Mr.
17 Barlow’s pre-filed direct testimony seem to indicate that PREMERA will provide each
18 foundation with separate representation (the “Designated Members”) on New
19 PREMERA’s Board. If PREMERA provides for separate Designated Members, then
20 this concern will be remedied.

21 4. The Consultants were concerned that the transfer of the Class B Share
22 was not memorialized adequately. If the Insurance Commissioner of the State of
23 Washington (the “Commissioner”) accepts the changes in the Proposed Modifications
24 regarding this issue, then this concern will be remedied.

1 5. The Consultants indicated that the Washington Foundation should have
2 the ability to vote on any new stock ownership plan that is effective after the Stock
3 Restrictions Period (as defined in C&B's Supplemental Report), but submitted to a
4 shareholder vote during the first two and one-half years of that period. In Mr.
5 Marquardt's pre-filed direct testimony, he explains that the language in the Voting
6 Trust and Divestiture Agreement (the "VTDA") did not reflect the intention of the
7 parties. If the Commissioner accepts the change in the Proposed Modifications
8 regarding this issue, then the general intention of the parties will be approximated in the
9 VTDA. However, the Proposed Modifications allow for free voting during the first two
10 years as opposed to the first two and one-half years of the Stock Restrictions Period.
11 Regardless, Mr. Marquardt's pre-filed direct testimony indicates that PREMERA is not
12 opposed to further modifying the Proposed Modifications to reflect a term of two and
13 one-half years "if approved by the Commissioner and the [Blue Cross Blue Shield
14 Association ("BCBSA").]" With the exception of the requirement of approval by the
15 BCBSA, which raises other concerns as discussed in C&B's Supplemental Report, if
16 the Commissioner is satisfied that PREMERA will make the Proposed Modifications,
17 then this concern will be remedied.

18 6. The Consultants were concerned that the Washington Foundation would
19 not have access to the information used in the development of the opinion to be issued
20 by the OIC's financial advisors regarding the economic viability of the initial public
21 offering (the "IPO Procedures Opinion"). Mr. Marquardt's pre-filed direct testimony
22 indicates that the lack of any restriction on the Washington Foundation's access to the
23 requested information implies that the Washington Foundation already has such access.
24 Alternatively, he indicates that if the Commissioner concludes that PREMERA's

1 consent is required for such access, then it shall consent to access that is reasonably
2 necessary. If access to the requested information is granted to the Washington
3 Foundation through one method or another, then this concern will be remedied.

4 7. The Consultants were concerned that PREMERA's Restated Articles of
5 Incorporation prevented the amendment of the Washington Foundation's organizational
6 documents, which in turn could handicap the Washington Foundation's ability to
7 achieve tax-exempt status. If the Commissioner accepts the changes in the Proposed
8 Modifications regarding this issue, then this concern will be remedied. Additionally,
9 the term "of the Washington Foundation" should be deleted in C&B's Additional
10 Supplemental Report Conclusion #19 in order to clarify the intent of that conclusion,
11 which is that PREMERA's Restated Articles of Incorporation prevented amendments to
12 the Washington Foundation's organizational documents as noted above. Thus, the
13 analysis in Mr. Marquardt's pre-filed direct testimony is no longer necessary because
14 this concern will be remedied if the changes in the Proposed Modifications are adopted.

15 8. Mr. Marquardt disagrees with concerns arising from the proposed
16 appointment of the Investment Committee by the Foundation's first Board of Directors,
17 mainly by arguing that there will be no assets for the committee to invest. If there is
18 nothing for the committee to do, why is there a need to appoint it? No assurance is
19 provided that this committee, appointed by PREMERA appointees, will not take steps
20 binding the Washington Foundation that might be viewed as undesirable.

21 9. The Consultants indicated that a preliminary proposal to the OIC's
22 advisors four weeks prior to the "roadshow" would be required in order for the IPO
23 Procedures Opinion to have greater reliability. If the Commissioner accepts the change
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1 made in the Proposed Modifications regarding this issue, then this concern will be
2 remedied.

3 10. The Consultants were concerned that the Plan of Conversion did not
4 reflect the intention that the closing as opposed to the mere pricing of the IPO should be
5 a condition for the conversion to be completed. If the Commissioner accepts the
6 change made in the Proposed Modifications regarding this issue, then this concern will
7 be remedied.

8 11. The Consultants were concerned that an ambiguity existed between the
9 Transfer Grant and Loan Agreement and the Washington Foundation's Articles of
10 Incorporation, because, under the former, the Washington Foundation could only
11 disburse funds to organizations that were tax-exempt under Section 501(c)(3) of the
12 Internal Revenue Code, but the latter permit disbursements to both Section 501(c)(3)
13 and 501(c)(4) organizations. If the Commissioner accepts the changes made in the
14 Proposed Modifications regarding this issue, then this concern will be remedied.

15 12. The Consultants expressed concern about treating the BCBSA's approval
16 as a trigger for the time from which PREMERA has twelve months to complete certain
17 conditions in order for the conversion to be effective. Thus, the Commissioner could
18 have approved the conversion upon the satisfaction of the conditions in the Form A, but
19 the twelve month time period in which to satisfy the conditions would not begin until
20 the BCBSA's approval, which in effect could extend for an indeterminate period the
21 twelve month window to complete the conditions. If the Commissioner accepts the
22 changes made in the Proposed Modifications regarding this issue, then this concern will
23 be remedied.

1 13. The Consultants were concerned with the sufficiency of the information
2 to be provided by PREMERA to the Consultants for the completion of the bring-down
3 opinions. In the Proposed Modifications, PREMERA has clarified one minor point in
4 Section 4.3(b)(ii)(D) of the Plan of Conversion. If the Commissioner accepts the
5 change made in the Proposed Modifications regarding this specific provision, then the
6 concern regarding Section 4.3(b)(ii)(D) of the Plan of Conversion will be remedied.
7 The other substantive issues, however, still remain outstanding in Section 4.3(b)(ii) of
8 the Plan of Conversion.

9 14. In addition to the Proposed Modifications, Mr. Marquardt takes issue with
10 certain points that were not addressed in C&B's Supplemental Report, but which will
11 be addressed in paragraphs 15 through 17 of my pre-filed responsive testimony.

12 15. Mr. Marquardt's pre-filed direct testimony states that prior to February 5,
13 2004, the Consultants did not object to PREMERA's veto right over all the candidates
14 selected by the Washington Foundation for the position of Designated Member.
15 Actually, the Consultants had disclosed previously their concern with PREMERA's
16 "carte blanche" authority to reject candidates who otherwise satisfied the qualifications
17 to be a PREMERA Board member. This concern was heightened further when
18 PREMERA refused to add a provision that would have permitted the PREMERA Board
19 members to have a veto right, but which required a written explanation of the reasons
20 for the veto, if exercised.

21 16. Mr. Marquardt indicates repeatedly that the Consultants relied upon the
22 conversion of the Empire BCBS Plan in New York (the "WellChoice Conversion") as
23 the conversion that incorporated "best practices." But, the Holding Company Acts do
24 not state that previous transactions are the standard by which a conversion in

1 Washington is deemed to be in the public interest. Previous transactions do, however,
2 provide a *general* guideline when analyzing the PREMERA conversion. Moreover, if
3 PREMERA does want to use the WellChoice Conversion to judge whether each
4 provision in the conversion documents are fair, then it should apply that same standard
5 to each provision that it has rejected, but which were part of the WellChoice
6 Conversion (*e.g.*, termination of the VTDA upon termination of the Blue Cross Blue
7 Shield name and trademark, separate 5% voting blocks outside the VTDA, a divestiture
8 schedule that is not aggregated, etc.). Indeed, the OIC consultants have made
9 abundantly clear at various times during their discussions with PREMERA that the
10 WellChoice transaction could not serve as the standard by which all of the terms of the
11 instant transaction should be gauged.

12 17. Mr. Marquardt takes issue with a statement in C&B's Supplemental
13 Report that PREMERA's failure to specify an allocation of shares between the
14 Foundations is "a fatal defect in the application." Actually, the full statement to which
15 PREMERA refers is as follows: "Assuming, as do the parties, that as a condition of its
16 conversion, PREMERA must satisfy charitable trust obligations in the two jurisdictions,
17 arguably this failure to specify the allocation of the Shares constitutes a fatal defect in
18 the application." That is, one could make the argument that without such an allocation,
19 whether by PREMERA or by the states, the application fails to deliver fair market value
20 to the Foundations. C&B, moreover, recognizes that PREMERA has attempted to
21 overcome this potential failure by proposing the Unallocated Shares Escrow
22 Agreement. The agreement, unfortunately, suffers from a number of infirmities, noted
23 in C&B's Supplemental Report, as the result of which it falls short of remedying the
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1 potential problems that would arise from the lack of a specified allocation by
2 PREMERA, or the lack of an agreed upon allocation by the states.

3 18. I declare under penalty of perjury under the laws of the State of
4 Washington that the foregoing is true and correct.

5 Dated April 13, 2004, at Austin, Texas.

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7 *Patrick H. Cantilo*

8 PATRICK H. CANTILO
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